

What Every Small Business Owner Should Know About Commercial Leases

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Understanding your commercial lease, and knowing what aspects and terms of your lease are negotiable at the outset can save a small business owner both time and money. Hiring an attorney to help you review and negotiate your lease before you sign it can help you to avoid many legal pitfalls, and can be a big cost-savings in the long run.

Commercial leases are different from residential leases in many ways. Commercial leases are not subject to most consumer protection laws that govern residential leases – for example there are no caps on security deposits. But more importantly, commercial leases are typically subject to much more negotiation between business owners and landlords than residential leases. Your ability to negotiate will naturally vary depending on your need for special features or accommodations to the lease and the landlord’s eagerness to have you as a tenant.

Most landlords and real estate brokers opt to use a form commercial lease agreement prepared by the American Industrial Real Estate Association (“AIR”) on behalf of commercial brokers and agents. Because this is a form lease, it does not address the specific concerns of many tenants (and landlords) so you should be prepared to negotiate to change the lease to better reflect your needs and concerns. Some landlords write their own “custom” leases, and you should be even more wary of those, since they were drafted to protect the best interests of the landlord. There are two basic categories of commercial leases: Modified Gross and Net (aka, triple net).

In the **Modified Gross Lease**, the tenant simply pays a stated amount each month. This rate covers all basic expenses that the landlord would normally incur including taxes, insurance, utilities, janitorial – and the rate does not change. Gross leases are used primarily in office buildings. Even though the landlord’s expenses are included in the first year, any increase in those expenses (known as Common Area Maintenance or “CAM” charges) are passed on to the tenant in subsequent years.

The **Net Lease** (aka, Triple Net) is almost the reverse of the gross lease. There is a quoted base rent, but the tenant is responsible for all the landlord’s costs incurred with the operation of the property – i.e., taxes, insurance, utilities, etc. The landlord pays for the expenses as they occur and each tenant pays in advance for their prorated share of those expenses based upon the percentage of square footage the tenant occupies. The landlord also provides some of the services needed for the common area and will assess a common area maintenance charge (CAM) to the tenants. Triple net leases tend to be used in warehouse and retail spaces.

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Following is a list of 9 important terms in your commercial lease that you, or your lawyer, should consider negotiating with your landlord. This list is not comprehensive, and you should consult with an attorney if you have any questions before signing a commercial lease.

1. Base Year and CAM Charges:

Most leases designate a “base year”, upon which future CAM, tax and insurance increases will be based. If the taxes, insurance and CAM exceed that amount for the following year, then the tenant will be responsible for its share of the difference between the base year and the following year. Therefore, try to push your base year out as far as possible to take advantage of not paying an increase for a longer period of time. Additionally, ask to exclude any property tax increases resulting from the sale of the property from being passed onto the tenant. If the landlord has held the property for a long time and has a below-market assessment base, you could get a huge bill when it sells.

2. Length of Lease:

Instead of trapping yourself in a long-term lease, limit your potential liability by negotiating for an initial shorter term, with multiple options to extend. The minimum initial term will vary greatly, depending upon how much the landlord is being asked to spend on tenant improvements. An option to extend can include a fixed price for a rental increase, which can be tied to a metric, such as the consumer price index (CPI) or can be at a “fair market value” to be determined later.

3. Personal Guaranty:

Most commercial landlords will require a personal guaranty from you, the owner of the business, to secure payment of rent. If your landlord has indicated that this is a requirement for your lease, then you should negotiate to limit the scope and duration of that guaranty in the event your business should fall on hard times. Specifically, you can and should negotiate to limit the personal guaranty so that it applies only to the payment of base rent and CAM charges, and/or capped at a certain amount or length of the lease. If somebody is injured on your premises, and if the victim’s damages exceed your insurance (or are not covered), you don’t want to expose your personal assets to these liabilities. Additionally, a guarantee of rent should be reasonable and not absolute. Example: a full guarantee for the initial 3 years and then a rolling 6 month guarantee thereafter.

4. Indemnity:

The indemnity clause is a standard provision in most commercial leases, and is designed to shift potential costs from one party to the other in the event of certain damages or injuries. A tenant should be careful not to sign a lease that includes an broad indemnity provision which protects the landlord by shifting potential costs to the tenant, but not vice versa. Make sure to negotiate to either remove such a one-sided provision, or to include a mutual indemnity clause.

5. **Security Deposit:**

Most commercial leases will require one to two months' rent as a security deposit. Unlike with residential leases, commercial landlords are not required to return security deposits within 21 days of the termination of the lease. Therefore, make sure the lease specifies a specific time period for the return of your deposit. If you believe that period is too long, try to negotiate to shorten it.

6. **Specifications re Space:**

Commercial landlords often divide up buildings and properties to rent to their tenants. It is important that you verify that your lease accurately and precisely defines the space you are renting – location and usable square footage, as well as any parking spaces and common areas that can be used. If you intend to measure the square footage of your space, do so before you sign your lease. Once you've signed, you will likely have little to no ability to dispute that the landlord misrepresented the square footage or description of the space.

7. **Intended Use:**

This clause is the most overlooked term in commercial leases. Make sure you read it carefully, and that it accurately reflects what you intend to do on the premises – i.e., the nature of your business. Moreover, make sure that the clause encompasses anything and everything your business may do in the future. You may “only” be operating a hair salon today, but you may decide you'd like to sell hair products next month. Try to negotiate to add the following language to this section: “and all other lawful related uses.” In addition to intended use, you may have the opportunity to negotiate for “exclusive” use. For example, if you'd like to ensure that you are the only and exclusive hair salon at the strip mall owned by your landlord, you should ask for an exclusive use clause.

8. **Maintenance:**

With respect to your leased space, commercial landlords are NOT responsible for most maintenance— unless you negotiate otherwise. (Commercial landlords are responsible for all maintenance and utilities with respect to common areas.) It is a good idea to hire appropriate professionals to inspect the premises and the equipment installed prior to signing the lease. By doing so, you can include a list of repairs to be completed at the landlord's expense as an Addendum to your lease. Unless a lease expressly states otherwise, a landlord has no obligation to disclose defects in the plumbing, HVAC, or any equipment installed in your space.

9. **Improvements and Modifications:**

If the landlord has agreed to make tenant improvements to the premises, make sure your lease has an Addendum that accurately defines those improvements, as well as who will be performing the work and who will be paying for the work. If the landlord is performing the work, include start and completion dates, and a clause setting forth remedies in the event the work is not done properly or in a timely manner.

The Small Business Law Firm, P.C. reviews commercial leases for our small business clients. Please reach out to use for a free initial consultation.

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